

UNITED STATES OF AMERICA
POSTAL REGULATORY COMMISSION
WASHINGTON, DC 20268-0001

Before Commissioners:

Robert G. Taub, Chairman;
Tony Hammond, Vice Chairman;
Mark Acton; and
Nanci E. Langley

Periodic Reporting
(Proposal Three)

Docket No. RM2018-6

NOTICE OF PROPOSED RULEMAKING ON ANALYTICAL PRINCIPLES
USED IN PERIODIC REPORTING (PROPOSAL THREE)

(Issued June 7, 2018)

I. INTRODUCTION

On June 1, 2018, the Postal Service filed a petition pursuant to 39 CFR 3050.11, requesting that the Commission initiate a rulemaking proceeding to consider changes to analytical principles relating to periodic reports.¹ The Petition identifies the proposed analytical changes filed in this docket as Proposal Three.

¹ Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Three), June 1, 2018 (Petition).

II. PROPOSAL THREE

Background. The Commission adopted the use of incremental costs as the basis for class-level and product-level attributable costs in September of 2016.² In FY 2017, the methodology was fully applied for the first time.³ Proposal Three seeks to revise two incremental costing procedures in accordance with this methodological change.

The first proposed revision concerns the Postal Service's method for calculating incremental costs for competitive products collectively. Under current analytical principles, the Postal Service calculates these costs using a so-called "hybrid" approach. The Postal Service first calculates the incremental costs of competitive domestic products (including group specific costs for these products) and then adds it to the volume variable and product specific costs of competitive international products. This "hybrid" approach blends an estimate of competitive domestic incremental costs with a proxy estimate of competitive international incremental costs.

The second proposed revision relates to estimating inframarginal costs for products with insufficient data at the cost pool level. The Postal Service states that this revision primarily concerns negotiated service agreements (NSAs), because NSAs are classified as independent products, which can have low volumes. Petition, Proposal Three at 1. Furthermore, the Postal Service contends that NSAs create practical issues in calculating incremental costs, in part because the Postal Service's data systems do not distinguish between NSA and non-NSA mailpieces. *Id.* at 13. This prevents the Postal Service from creating the standard cost drivers for NSAs (e.g. volume, weight, cubic volume), which are necessary for calculating incremental costs. *Id.*

Proposal. As discussed above, the Postal Service proposes two procedures to revise its calculation of incremental costs.

Under procedure one, the Postal Service seeks to replace the "hybrid" approach to calculating aggregate incremental costs, which relies on a proxy for international

² Docket No. ACR2017, Annual Compliance Report, December 29, 2017, at 4-6.

³ Docket No. ACR2017, Annual Compliance Determination, March 29, 2018, at 8.

costs, with a direct estimation of those costs. *Id.* at 4. Due to improvements suggested in the FY 2016 Annual Compliance Determination, in conjunction with corresponding analytical improvements, the Postal Service states that it can now directly estimate the actual incremental costs of international mail. *Id.* at 6.

Under procedure two, the Postal Service proposes thresholds for calculating inframarginal costs and an alternative methodology for approximating the appropriate cost driver ratios for NSAs. *Id.* at 8. Specifically, the Postal Service suggests that it should not have to calculate the incremental costs if an NSA has less than 0.3 percent of the product type's (e.g. Priority Mail, Parcel Select) volume variable cost or less than \$8 million in volume variable cost. *Id.* at 11. The Postal Service also seeks to use the ratio of NSA volume variable costs to product type volume variable costs as a proxy cost driver to calculate the incremental cost of NSA products. *Id.* at 12-20.

Rationale and impact. The Postal Service contends that procedure one will allow it "to rely upon the best available information" because the procedure replaces the hybrid approach's proxy incremental costs with actual estimation of the incremental costs of international products. *Id.* at 7. The Postal Service comments that "[t]his alone constitute[s] a clear improvement over past practice." *Id.* at 6. Furthermore, the Postal Service notes that the change will allow "the incremental cost model to directly estimate the costs of producing all competitive products simultaneously, and thus provide exactly the information needed to fully conduct the cross-subsidy test as intended." *Id.* at 7.

The Postal Service estimates that the impact of procedure one would be to raise competitive product incremental costs by 0.2 percent. *Id.* at 7-8. The Postal Service estimates that amount to be approximately \$25 million. *Id.*

The Postal Service argues that procedure two's proposed thresholds are appropriate because its testing suggests that NSAs "have no appreciable inframarginal costs" below these thresholds. *Id.* at 11. The Postal Service argues that "when a product has a very small volume relative to the other products handled in the activity or cost pool, the product's volume variable cost and incremental cost will virtually be the same." *Id.* at 9. For that reason, the Postal Service avers that "the calculation of

incremental costs for the hundreds of domestic NSA's with minimal volumes would require a material amount of scarce Postal Service resources, and the resulting incremental cost estimates for those products would not be practically different from their volume variable costs." *Id.* at 12. The Postal Service concludes that it and the Commission "are better served when the Postal Service expends those resources on other, critical, costing issues." *Id.*

With regard to procedure two's proposed cost driver change, the Postal Service states that it "is not possible . . . to generate the required cost driver proportions for specific NSA products." *Id.* at 13. For this reason, the Postal Service proposes to use "the volume variable cost ratio as a proxy for the unknown true variable, the ratio of the cost drivers." *Id.* at 17. In the Postal Service's view "the approximation used for the missing driver ratios should reflect the characteristics of the missing information as well as possible." *Id.* at 13.

The Postal Service states that the impacts associated with procedure two are "less clear cut" than procedure one because "there is no intuitive baseline against which to compare [results]." *Id.* at 20. The Postal Service explains that "[i]n theory, the logical baseline would be actual inframarginal costs calculated using actual data at the cost pool level." *Id.* However, "since the very reason we must rely on the approximation is because such actual data at that level do not exist, that theoretical baseline does not exist either." *Id.*

III. NOTICE AND COMMENT

The Commission establishes Docket No. RM2018-6 for consideration of matters raised by the Petition. More information on the Petition may be accessed via the Commission's website at <http://www.prc.gov>. Interested persons may submit comments on the Petition and Proposal Three no later than June 29, 2018. Pursuant to 39 U.S.C. 505, Katalin K. Clendenin is designated as an officer of the Commission (Public Representative) to represent the interests of the general public in this proceeding.

IV. ORDERING PARAGRAPHS

It is ordered:

1. The Commission establishes Docket No. RM2018-6 for consideration of the matters raised by the Petition of the United States Postal Service for the Initiation of a Proceeding to Consider Proposed Changes in Analytical Principles (Proposal Three), filed June 1, 2018.
2. Comments by interested persons in this proceeding are due no later than June 29, 2018.
3. Pursuant to 39 U.S.C. 505, the Commission appoints Katalin K. Clendenin to serve as an officer of the Commission (Public Representative) to represent the interests of the general public in this docket.
4. The Secretary shall arrange for publication of this Order in the *Federal Register*.

By the Commission.

Stacy L. Ruble
Secretary